

No. 14047

United States
Court of Appeals
for the Ninth Circuit

RALPH H. EATON FOUNDATION,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Transcript of Record

**Petition to Review a Decision of
The Tax Court of the United States.**

FILED

DEC 28 1952

PAUL F. O'BRIEN,
CLERK



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United States
Court of Appeals
for the Ninth Circuit

RALPH H. EATON FOUNDATION,

Petitioner,

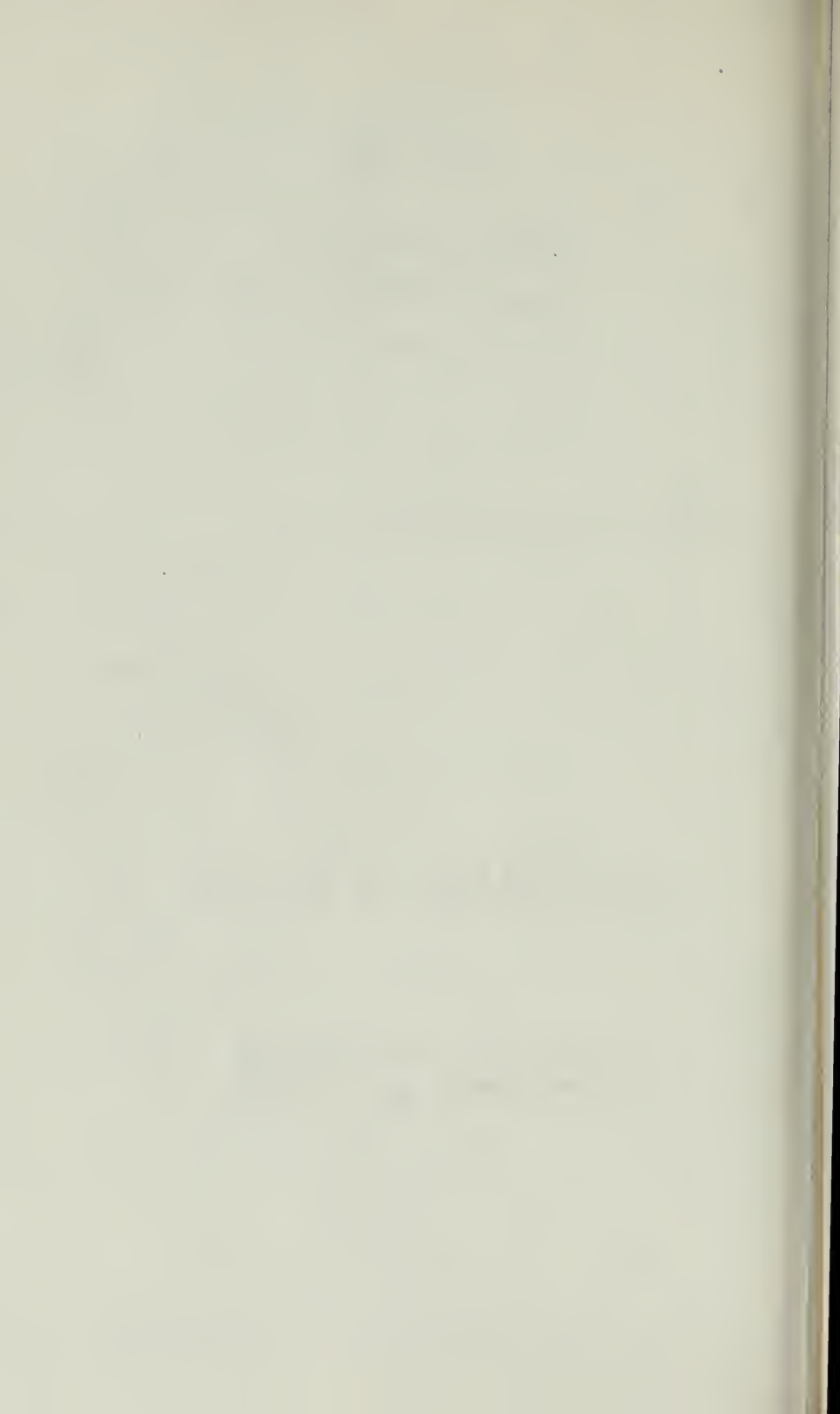
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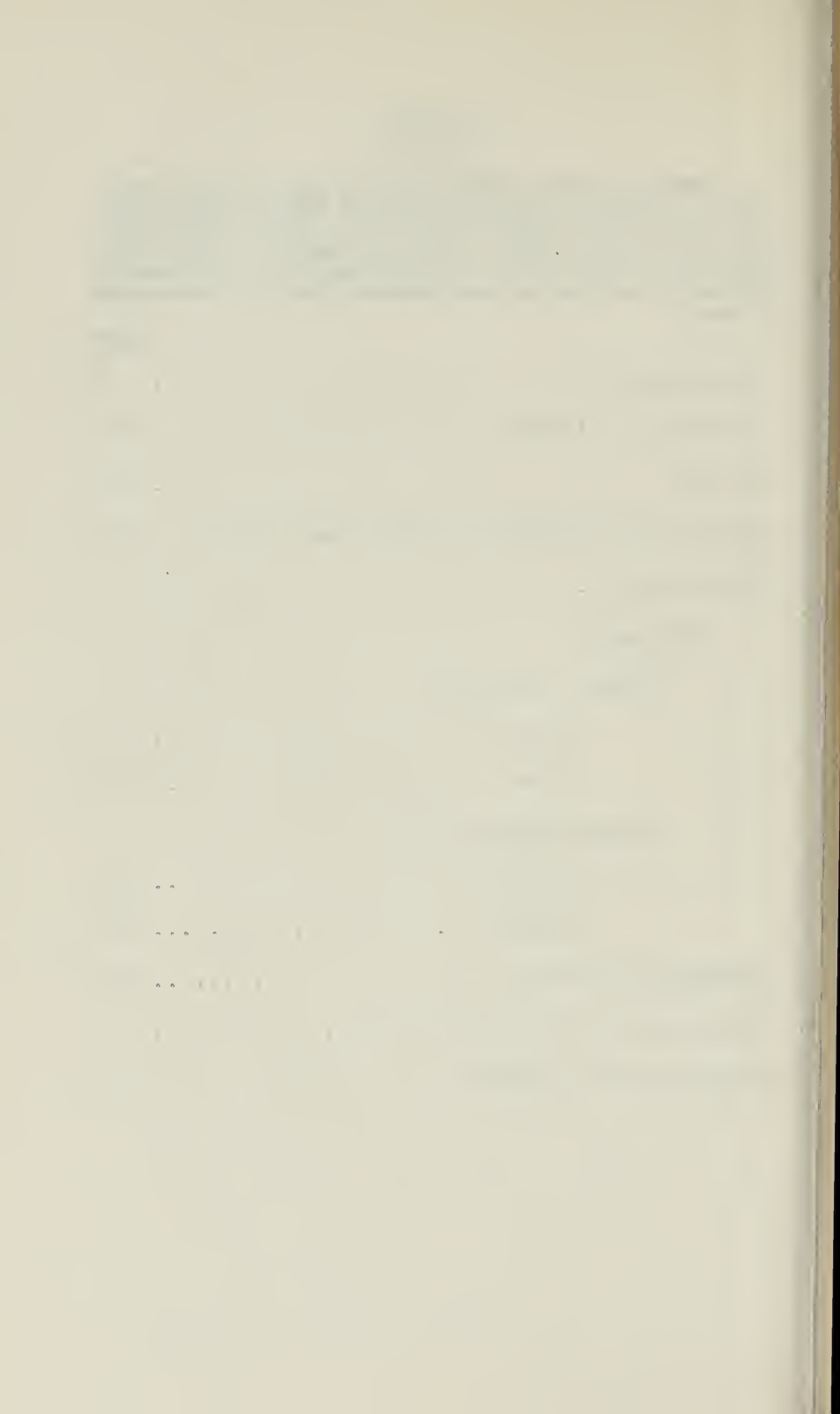
**Petition to Review a Decision of
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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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APPEARANCES

For Petitioner:

MARTIN H. WEBSTER, ESQ.;

H. M. WEBSTER, C.P.A.

For Respondent:

H. B. MUIR, ESQ.;

R. E. MAIDEN, JR., ESQ.

THE HISTORY OF THE

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In The Tax Court of the United States

Docket No. 30985

RALPH H. EATON FOUNDATION,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

STIPULATION

It is hereby stipulated by and between Ralph H. Eaton Foundation, Petitioner, and the Commissioner of Internal Revenue, Respondent, by their respective counsel, that the following facts shall be taken as true; provided, however, that this stipulation shall be without prejudice to the right of either party to object at the hearing to any part thereof on the grounds of immateriality, or to introduce other and further evidence not at variance with the facts herein stipulated.

* * *

12. The facts set forth in this Paragraph 12 relate to the farming operations of Petitioner:

(a) To enable Petitioner to engage in the farming business, Ralph H. Eaton and Frances M. Eaton, in March, 1947, gave to Petitioner without consideration certain farm and office equipment described as follows which had been purchased by Ralph H. Eaton and Frances M. Eaton in October and November, 1946 at cost figures indicated below:

John Deere Tractor & Tools	\$1,565.68
Weed Burner and Spray	18.34

Land Roller	177.84
Four-Drawer Office File	81.80

Total.....\$1,843.66

Ralph H. Eaton and Frances M. Eaton further transferred to Petitioner at or about that time all their right, title and interest in and to certain growing crops against which they had advanced to the date of said transfer the sum of \$3,520.79; and Petitioner agreed to pay said sum to Ralph H. Eaton and Frances M. Eaton.

* * *

13. The facts set forth in this Paragraph 13, relate to the real estate selling operations of Petitioner:

(a) In April and May, 1945, Ralph H. Eaton purchased 110 acres of land on West McDowell Rd., between 33rd & 35th Avenues, in Phoenix, Arizona, and transferred the same to the Phoenix Title and Trust Company, Phoenix, Arizona, as Trustee, under the latter's Trust Agreement Nos. 605 and 660. The intent and purpose of such acquisition was to subdivide said land, and said land was in fact subdivided into lots. At or about the time of acquisition of said land, a 1/10th interest therein was sold to George Heiskell. On April 1, 1947, Ralph H. Eaton and Frances M. Eaton gave to Petitioner without consideration their remaining 9/10ths interest in and to said Phoenix Title and Trust Company Trusts. At a meeting of Board of Directors of Petitioner duly held on April 1, 1947, Petitioner accepted said gift. At the time of said

gift, the net cost to Ralph H. Eaton and Frances M. Eaton of the donated interest was \$27,410.62.

* * *

14. The facts set forth in this Paragraph 14 relate to the construction operations of Petitioner.

* * *

(c) At a meeting of the Board of Directors of Petitioner held on January 1, 1948, Ralph H. Eaton and Thomas H. Kent, Jr., met with George Heiskell and after some discussion it was agreed between Petitioner and George Heiskell that Petitioner would purchase the interest of George Heiskell in and to said partnership of Eaton & Heiskell Construction Co., for the book value thereof as determined by a Certified Public Accountant. At said meeting, Ralph H. Eaton also gave to Petitioner without consideration his interest in and to said partnership, and Petitioner duly accepted said gift. From January 1, 1948, Petitioner has operated a construction business under the name of Eaton & Heiskell Construction Co.

* * *

16. Ralph H. Eaton and Frances M. Eaton have each contributed a great amount of time and effort to generally supervise the activities of Petitioner.

* * *

Dated: May 20, 1952.

/s/ MARTIN H. WEBSTER,
Counsel for Petitioner.

/s/ CHARLES W. DAVIS, ECC

Chief Counsel, Bureau of Internal Revenue, Counsel for Respondent.

Filed May 20, 1952, T.C.U.S.

The Tax Court of the United States

Docket No. 30985

RALPH H. EATON FOUNDATION,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PROCEEDINGS

May 20, 1952—10:15 A.M.

(Met pursuant to notice.)

Before: Honorable Clarence V. Opper, Judge.

Appearances:

MARTIN H. WEBSTER,

Appearing for the Petitioner.

R. E. MAIDEN, JR.,

(Honorable Charles W. Davis, Chief Counsel, Bureau of Internal Revenue),

Appearang for the Respondent.

RALPH H. EATON

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows: [13*]

* * *

*Page numbering appearing at top of page of original Reporter's Transcript of Record.

(Testimony of Ralph H. Eaton.)

Direct Examination

By Mr. Webster:

Q. Will you please state to the court, Mr. Eaton, the purpose in your own mind for the formation of this foundation?

A. Exactly as stated in the articles, foster and promote Christian, religious, evangelistic, missionary endeavors and enterprises.

Q. Now, it has been stipulated that your wife was also an incorporator and a director of the Petitioner during the tax years involved here. Did you discuss the matter of the formation of the Petitioner with your wife prior to March, 1947?

A. Yes, certainly. I believe I told her about my vision and desire immediately upon my return from New York.

Q. What was her attitude?

A. She was definitely interested also. We see eye to eye on those things. She goes right along with me. Our views and our ideas are very nearly always the same. [20]

* * *

Q. In your discussions with your wife in connection with the establishment of this foundation, did any of those discussions relate to the matter of your family finances?

A. Yes, because certainly my family was involved. My boy, the oldest son, who is 16 years old, is particularly interested and always is when he

(Testimony of Ralph H. Eaton.)

can get in on a conversation with my wife and I about the foundation; he is very happy about it. Even my daughter, 12 years old, is interested to a certain extent. She doesn't understand it all, of course, but my son is very anxious to have a part in it. In fact, he has asked me and he is planning to become one of the directors of the foundation. I might state that we plan, if his interest continues, to make him a part of it and perhaps the other children.

Q. Now, Mr. Eaton, I had asked you whether in your discussions with your wife, you had discussed the matter of the effect of the foundation upon your family finances. Had you had such discussions with your wife?

A. Yes. Excuse me for sidetracking you. We certainly have, but stating it frankly, we have an income that is sufficient for our family. We don't require a large income. I think my family and I live on a moderate income, and our [21] interest above that is, sir, frankly, to give to the Lord's work, and that position is borne by each of the members of the family, particularly by my wife, of course. [22]

* * *

Q. Now, in the discussions that you had and which you have testified to with your wife and Mr. Kent, was there any discussion as to the manner in which the foundation was supposed to fulfil the purpose which you say was in mind at the time of the formation?

(Testimony of Ralph H. Eaton.)

A. Well, if I may state it this way, we wanted to give funds and money to Christian work.

Q. Was there any discussion as to the manner in which those funds were to be acquired by the foundation?

A. Well, naturally there would have been. Our discussions would be along the lines of gifts and entering into various other phases of business that would produce income for the purpose of giving it to these Christian organizations that we had an interest in and a desire to help. [23]

* * *

Q. Now, it has been stipulated that the foundation entered into four different kinds of businesses, farming, construction, selling sport clothes and the selling of real estate lots. It has also been stipulated that the farming business was conducted during the two tax years that are involved here, that the subdivision business was conducted during the two tax years that were involved here, and that the construction business was undertaken from January 1, 1948, and on during the balance of period involved here, and further that the sale of the sport clothes was conducted during the period from June 2, 1947, to June 1, 1948. Would you state to the court why it is that the foundation entered into these businesses?

A. Yes. We wanted to have money available, earn money [24] for giving, contributing to Christian activities just as I have stated before.

(Testimony of Ralph H. Eaton.)

Q. Now, were there discussions among the directors of the foundation when the foundation entered into a particular business?

A. Definitely so, yes, always.

Q. Was there complete agreement at all times?

A. In every case. [25]

* * *

Q. Now, in connection with the farming operations of the foundation. It has been stipulated that you leased certain lands to the foundation. I would like to ask this question of you as to the manner in which the rent was determined, [32] that would be charged to the foundation in each case.

A. We determined it on a fair and equitable basis, and in every case the rent was not more than the average rental, going rental rate in the area, in the district. Sometimes less.

Q. Could you explain how you arrived at the average rental in the area?

A. Well, that was very easy in my particular case, because I happen to handle the leases for the Eaton Fruit Company, and we rent thousands of acres, I mean, we have rented thousands of acres over the years, and through that medium I know what land is renting for. Besides, it is a common knowledge in the produce business of what land, what other shippers and growers are paying for similar land. [33]

* * *

Q. Now, when you acquired this Swant ranch in

(Testimony of Ralph H. Eaton.)

July 1, 1948, and then leased it to the Petitioner for a year at \$40 per acre per year, would you state your opinion as to whether that rental was equal to, less than, or greater than the average prevailing rent to comparable land in this area?

A. I would say that it certainly was not more than the average rental. If anything, it would be a little less, because the rental figure had started upward, I mean it had come upward all of those years.

Q. Well, now, when you say that the rental figure came up all of those years, what do you mean?

A. Back in 1943, along in there, there started a gradual climb of rentals for land. Another reason we set the [36] figure at that, was the fact that immediately after purchasing the ranch, we started improvements on the ranch and several thousands of dollars in improvements were added to the ranch.

Q. You say, "we added improvements to the ranch." Who do you mean?

A. The foundation. I am speaking of the foundation when I say that. When I say improvements in that particular case, that was myself personally. I beg your pardon. I personally paid for the improvements. The foundation only rented the land and paid the rent and received the benefits of the improvement.

Q. Approximately what was the cost of those improvements that you are talking about?

A. I don't recall the exact amount, but I would

(Testimony of Ralph H. Eaton.)

say that there was \$2,500.00 to \$3,000.00 worth of improvements in about that period. [37]

* * *

Q. Turning again to the original question that I asked you, the \$40.00 per year that you leased the Swant ranch for to the foundation, I would like to hear it again whether it was equal to, greater than or less than the average rental.

A. Equal to or less than. There has been too much of a variance there, because there are different figures depending on the location of the land and the fertility of the soil and availability of water. That is one of the biggest questions in Arizona, of course. [38]

* * *

Q. I will now call your attention to the so-called "Mann Lease" which is described on page 8 and page 9 of the stipulation that is on file. According to that stipulation the foundation leased this ranch from T. A. Mann for a period from August 1, 1947, to July 31, 1948, at a rental of \$35.00 per acre per year. I ask you whether that rental was equal to, greater than, or less than the average rental for comparable land in this area.

A. I would say for comparable land that it was about in line, perhaps just a little bit lower because the fertility of that particular piece of land had gone down somewhat through continuous farming.

Q. Well, if the fertility was reduced, would that

(Testimony of Ralph H. Eaton.)

make the rent higher than the average or lower than the average?

A. Lower than the average. [39]

* * *

Q. I will call to your attention the "L Avenue Ranch Property" which is described on pages 6 and 7 of the stipulation on file. This property was leased by you to the foundation from February 1, 1947, to January 30, 1948, at \$40.00 per acre per year. Now, this was roughly during the same period that the Petitioner leased the Swant ranch from Mr. Swant at \$30.00 per acre per year, and the Mann ranch at \$35.00 per acre per year. Would you explain how it is that the "L Avenue Ranch" was leased at a higher rental than the other two ranches?

A. Well, in the first place, I personally had leased [40] that "L Avenue Ranch" to Eaton Fruit Company for \$40.00 previous to this date which you have mentioned. I was receiving \$40.00 per acre. Then, too, there was included in this lease—

Q. Pardon me. In what lease?

A. In the "L Avenue Lease" by the foundation, improvements which included a house, barns, a domestic well and all of those things for farming. The house alone had been rented for \$85.00 a month.

Q. Now, when the "L Avenue" property had been rented by you to Eaton Fruit Company at \$40.00 per acre per year, as you testified, did that \$40.00 per acre per year include the use of the whole place that was on the property?

(Testimony of Ralph H. Eaton.)

A. No, it did not. No, I received that separately. The improvements were not included.

Q. You testified that as to the foundation, however, when you leased it for \$40.00 per acre per year, it did include the use of it?

A. Mr. Eastes, the foreman, occupied the quarters there. [41]

* * *

Q. I will call your attention to the Ramona Road lease which is described in the stipulation on pages 7 and 8. Now, the stipulation shows that on or about April 1, 1948, you purchased 40 acres of farm land on Ramona Road in Phoenix, and that on April 1, 1948, you leased 35 acres of it to the Petitioner from April 1, 1948, for a full year at \$40.00 per acre per year. Would you be able to state whether this rental charge was equal to, greater than, or less than the average rental in the area for comparable land?

A. I would say that in this particular area it was less than the average rental. That happens to be in a section of Phoenix, which was growing with subdivisions and the land was more valuable, therefore required a greater rental figure. There, then, there were improvements on that ranch also. [42]

* * *

Q. I will call your attention to the Rousseau lease for the Rousseau ranch, described on page 8 of the stipulation. That shows that for six months, from July 1, 1949, the foundation ~~purchased it and~~ leased the Rousseau ranch at a rental rate of \$60.00 (Testimony of Ralph H. Eaton.)

per acre per year. Would you state whether that was equal to, greater than, or less than the average rental in the area for comparable land?

A. I would say about equal to. It happened to be that we only leased that for a half year and only through the friendship of the foundation foreman and the owner, Mr. Rousseau, were we able to get it because other companies were bidding on it and he could have rented it for \$30.00. [More.]

Q. Is the Rousseau ranch located in an area comparable to any of the other locations of ranches which the Petitioner also leased?

A. Yes, within a mile.

Q. Of what?

A. Of the Swant ranch, a mile and a half.

Q. Of the Swant ranch? A. Yes. [43]

* * *

Q. Now, Mr. Eaton, in the tax return that was filed by the foundation for the fiscal year ending January 31, 1949, and which constitutes Exhibit No. 6-F, I believe, attached to the stipulation, there is shown an item of interest in the sum of \$1,088.58 paid to Ralph H. Eaton, Phoenix, Arizona; is that you? A. That is right.

Q. Would you explain the circumstances for that interest payment?

A. Well, we had to have money to operate the foundation, and the foundation didn't have a credit standing with the bank sufficient enough to borrow money, at least, and I borrowed the money personally at the bank in my own personal name, and in

(Testimony of Ralph H. Eaton.)

turn loaned it or advanced it to the foundation. Naturally, I had to pay interest at the bank, therefore, from a business standpoint I charged interest to the foundation. Even more than that, I couldn't afford to do more than that. I had already given—like I have stated, there is just a limit to what one can do. There is a limit to what one can do in the way of giving.

Q. What is the comparison between the amount you charged the foundation as interest and the amount that you paid over to the bank as interest for the same amount of money? [44]

A. I think that the interest rate would be the same. Actually, I believe, the records will indicate that I paid about \$1,400.00 in interest that year, and I received from the foundation something over a thousand, a little over a thousand.

* * *

Q. So, that apparently according to your testimony the only items of tangible value that you received were rent, this interest item that we talked about, a payment for costs advanced by you on growing crops, and repayment of loans. Is that correct? [45]

A. That is right. I would like to state I have never received any compensation for services rendered to the foundation in any way whatsoever, and never intended to. We made it very definite and plain right from the beginning before it was ever

(Testimony of Ralph H. Eaton.)

incorporated that there would never be any compensation to me personally, nor to my family.

* * *

Q. Now, do either you or your wife expect to receive at any time compensation for services that you rendered during [46] the tax years here in question?

A. No, definitely not. That is very definite.

Q. I ask you whether the foundation during the tax years here involved ever engaged in carrying on propaganda or otherwise attempted to influence legislation?

A. No, we haven't. That isn't our purpose at all.

Q. Now Mr. Eaton, let me ask you this question; do you have any immediate plans for the dissolution of the foundation?

A. Yes, we have gone into that, as far as dissolving it. We do expect to go on and on. I want my family to be part of it and carry it on indefinitely. I don't know how long, of course, but long after I am gone.

* * *

Q. Now, do you happen to know, Mr. Eaton, what happens [47] to the assets of the foundation in the event of a dissolution of that foundation?

A. Well, that has been a question in Arizona, from the attorney who drew up the Articles of Incorporation. He couldn't find any definite cases, as I recall him stating to me on that, but it has been our belief and understanding between the board of

(Testimony of Ralph H. Eaton.)

directors, Thomas Kent and my wife and the attorney and everybody that has been involved, or had anything to do with the foundation, that the money would be distributed to the charities, the approved charities as listed in the bylaws in the Minute book and would go definitely for the causes for which it was set up.

* * *

Q. When did you have these discussions with Mr. Weaver on the question of what happens to the assets of the foundation on dissolution?

A. At the time we set it up, we went into thorough details about those things. It was understood that that would be a point. We are now preparing and planning and working on a change in the bylaws or articles, whatever it takes to [48] effect that, so that it will conform with Arizona law, that positively nothing can accrue or come to me or my family in case of dissolving the foundation. That is definitely understood. My family understands that. Tom understands that. We never had any other desire or intention. I realized when I made a contribution to set up the foundation of \$50,000.00 that I had known that none of that money, not one penny of it, could ever come back to me in any way. I knew that when I gave it. [49]

* * *

Q. Well, now, let me ask this question. Until this last month or so, as you say, what was your understanding, if any understanding, that you had

(Testimony of Ralph H. Eaton.)

on the question of what happened to the assets of the foundation upon dissolution?

A. Well, like I stated before, it has always been in my mind and I have always understood and have taken for granted that the money, the assets of the foundation would go to the charities and to the Christian organizations that are listed in the Minute book, those approved, because that is what it was set up for in the first place, and there is no desire to do anything else with it. There has never been any idea of anything else.

Q. Is your testimony then, to the effect that within the last month or so, you have learned that possibly that would not be true. Is that your testimony?

A. Well, something to that effect, but we want to make it so that it is definite and specific, so that it can't be otherwise, and propose to do that just as quickly as possible. [50]

* * *

Q. Mr. Eaton, I refer your attention to Exhibit 3-C, which is attached to the stipulation that is on file, and I direct your further attention to question number 16 which is contained on page 3 of that exhibit, that exhibit being the exemption affidavit that was filed by the foundation.

Question number 16 reads as follows: "In the event of the dissolution of the organization, what disposition would be made of its property?"

Apparently, the answer that was typed in, it was

(Testimony of Ralph H. Eaton.)

to be disbursed to charitable and religious organizations.

According to the exhibit, you signed this form as president of the foundation on June 15, 1948. Would you kindly state whether or not that represented your understanding of the situation at that time? A. It did.

Q. Is that your understanding of the situation today?

A. Well, it has been brought to my attention only recently and that because of filing a new exemption under the new 1950 Revenue Act, I believe by our attorney, that we should take steps to amend our articles to specifically carry that provision out as it is stated. [63]

* * *

Cross-Examination

By Mr. Maiden: [64]

* * *

Q. But you do recall that that question did arise at [65] the time you were incorporating?

A. I would like to restate again that my desire and my intentions and my statements to him and to everyone else concerned with the foundation was that there never would accrue to me in any way, nor to my family, anything from the foundation. I stood on that and he being my attorney was supposedly to follow through. I relied on his judgment in setting it up. I state again, as is outlined in this exemption,

(Testimony of Ralph H. Eaton.)

I never had any understanding whatsoever other than the fact that if the foundation was dissolved that the assets and everything left would go to the charities for which it was intended to go.

Q. You were aware, were you not, Mr. Eaton, that under the Articles of Incorporation that the directors of the foundation were not required, actually required to turn over any money to any charities, that it was a matter left entirely to their discretion. You understood that?

A. I understood it to this end only, that we had the position of directing that money, but I never did have any understanding that any of the money would not go to charities, but always that it would go there. There is no question in my mind or has there ever been. [66]

* * *

THOMAS H. KENT, JR.

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows: [70]

* * *

Direct Examination

By Mr. Webster. [71]

* * *

Q. I wonder if you will state briefly for us the reasons why you became associated with the foundation, as an incorporator, as an officer and as a member of the board of directors?

(Testimony of Thomas H. Kent, Jr.)

A. I was a Christian prior to my coming to Arizona. When I came here, I transferred my membership to the Capital Christian Church, where under the teaching of a very godly minister, I came to realize more fully God's purpose in my life. I became associated with Christian organizations outside of my own church. It was through meeting Christian men that I grew and also by working for the Eaton Fruit Company.

I was first told by Mr. Eaton of his vision.

Q. Mr. Ralph Eaton?

A. Ralph Eaton, of his vision to establish a foundation which would be able to further his Christian interests. Being interested in like things, I naturally thought it was swell, and I told him so. I told him I would be willing to help him in any way that I could to so establish it and to [73] further the purpose for which it was established.

* * *

Q. Are you aware of any activities of the foundation itself which were undertaken by the foundation and which you were not consulted upon?

A. I know of nothing. I definitely believe that I was consulted in ~~confidence~~ advance prior to any action which was ever taken and for which anything was ever done.

Q. Does that include the payment of interest to Mr. Eaton?

A. A CPA audited our books that year and [I] myself personally calculated the interest amount

(Testimony of Thomas H. Kent, Jr.)

due based on the actual [74] fund which we had that year.

Q. How about the payment of rent to Mr. Eaton by the foundation?

A. I personally drew the leases for that land. From experience with the farming industry and the general situations in Phoenix and as a land owner from my prior association with Eaton Fruit Company, I knew and felt the amounts were [75] proper.

* * *

Q. Now, Mr. Kent, just before you took the stand, [76] you heard his honor address certain questions to me, specifically related to the amounts that were given by the foundation to certain organizations in each of the tax years that were involved. We have stipulated that in the first period which went from March 12, 1947, to January 31, 1948, a total amount of \$4240.00 was distributed in the manner indicated. For the fiscal year ending January 31, 1949, a total of \$2310.00 was distributed in the manner indicated. I would like you to explain how it is that those amounts were arrived at and if necessary to consult such books and records as you might have brought with you in order to complete your answer.

A. Well, I will try to answer it satisfactorily without that. The amounts were not arrived at in any specific manner as certain appeals were made to us or certain occasions arose which were needful of contribution to the charities so named. We made

(Testimony of Thomas H. Kent, Jr.)

the contributions at the time. Now, as far as monies available are concerned, a sizeable amount of the income was towards the latter month—in other words, your fall crop of lettuce which isn't harvested until December and early January, and the actual profits accrued from that crop are not determined until actually at the end of the accounting year, so it was not practical to distribute any funds from that, or to even know that you had made money. Another factor involved in the apparent high income was that in our setup of accounting on the books, all the expenses [77] pertaining to the cost of development of the subdivision were charged as expenses and only that portion of payment, which in many cases might have only been a twenty-five or fifty-dollar down payment, were taken as income instead of the sale price with a balance of a contract as accounts receivable, therefore, the cash was not actually available to us even though you have that profit on the books. That partially answers your question.

Q. Now, would you elaborate on the cash position of the foundation during the two years that are involved here with respect to the amounts that were given to organizations eligible for foundation funds?

A. During the year 1947, ending in January 31, 1948, I believe that the highest bank balance during the period was about \$12,000.00. The lowest was less than a thousand. Due to business operations, it so happens that at the end of the year because of the fall lettuce sales coming in, the bank account was a little over \$30,000.00. By May of that following

(Testimony of Thomas H. Kent, Jr.)

year, which is 1948, ending the second year, the balance was again less than a thousand dollars. The operation of the construction business which we took over on January 1, 1948, right at the end of the first period, required the additional cash that was made available in the first period to operate and take it over.

Q. Mr. Kent, are you familiar with any standards, [78] that might have been used by the board of directors of the foundation in determining the exact amount of money or the actual amount of money that was distributed during the course of a year to the objects of the foundation?

A. During the period of 1947, during the first accounting period, I know of nothing. We just gave as the money was available and as the need was there. Coming into 1948, after taking over the construction company, we did not have too many funds available. It was sort of a scratch affair. Contract payments do not always come in as fast as you expect. There was not the money available. We didn't have any schedule and actually don't have now any set rule of how much we are going to give in any one calendar period. Is that what you meant?

Q. Yes.

A. There are no rules to go by. Our rules are based as the need arises and when we have the opportunity to make the investment like that to a charitable organization. We are approached by need. We see what we can do about it, and then make the

(Testimony of Thomas H. Kent, Jr.)

gift accordingly and the amounts in accordance with it.

Q. Now, Mr. Kent, I should appreciate a statement from you if you are able to make one, with respect to your understanding as an officer and a member of the board of directors of the foundation, as to what happens or what would [79] have happened if the assets and property of the foundation had been dissolved in any of the tax periods that are involved here.

A. It has always been my understanding that in case of dissolution—we never considered that—that some day if the assets were dissolved, they would be given away to the beneficiaries of charitable contributions. We never had any intentions or thoughts of dissolving it, but the only case that has ever come up which would be the conversation between me and an employee of the auditing firm, just conversation.

“What are you going to do?”

“Just liquidate it and give it all away.”

That is just conversation. We always intended that. However, there is no intention of dissolving it that I know of. We never contemplated that. [80]

* * *

Q. If the matter were presented to you for a vote, as a member of the board of directors of the Petitioner, as to the question of whether the assets or property of the foundation would be distributed definitely to charities, what would your vote be?

A. My vote would be that the cash be distributed

(Testimony of Thomas H. Kent, Jr.)

and the assets liquidated, the cash obtained to be distributed to charities as had been approved prior to that time by the board of directors. [81]

* * *

The Court: If you came to a point at which there was a conflict of interest, in which by taking a certain action the Petitioner foundation benefited on the one hand and by taking a different action Mr. Eaton would benefit on the other, which way would you cast your vote as a director?

The Witness: I believe that I would vote as my duty requires me both before God and as the director of the foundation, that I would vote to the interest of the foundation and to the purposes for which it has been established. [87]

* * *

Redirect Examination

By Mr. Webster:

Q. Mr. Kent, do you know whether the pendency of this case has had anything whatever to do with the amounts that have been distributed by the foundation to designated beneficiaries over the periods from May, 1949, to date?

A. It is only natural since the Treasury Department has refused to accept our status that it will be necessary to keep a reserve of cash. However, we haven't done it but we would like to, but upon the

(Testimony of Thomas H. Kent, Jr.)

recommendations of our attorneys in succeeding years, we should not be too careless in giving away everything we have had.

* * *

Filed June 15, 1952, T.C.U.S. [96]

The Tax Court of the United States

Docket No. 30,985

MEMORANDUM FINDINGS OF FACT
AND OPINION

Opper, Judge:

Respondent determined deficiencies in petitioner's income tax liability and imposed delinquent filing penalties as follows:

Tax Period	Deficiency	Penalty
3/12/47 to 1/31/48	\$23,263.05	(25%) \$5,815.76
2/ 1/48 to 1/31/49	1,223.88	(10%) 122.39

The questions presented are whether petitioner was an exempt charitable corporation within the meaning of section 101(6), Internal Revenue Code,

and whether petitioner had reasonable cause for failing to file timely income tax returns.

Findings of Fact

Some of the facts have been stipulated and are found accordingly.

Petitioner is a corporation organized under the laws of Arizona in March, 1947. Its income tax returns for the periods in controversy were filed with the collector for the district of Arizona.

Petitioner's incorporators were Ralph H. Eaton, Frances M. Eaton, his wife, and Thomas H. Kent, Jr. They were elected directors of petitioner and also president, vice president and secretary-treasurer, respectively, which positions they still held in May, 1952. Petitioner has no capital stock outstanding and no subscriptions thereto. The Articles of Incorporation expressly prohibit the issuance of capital stock.

Petitioner's Articles of Incorporation describe the nature and purpose of its proposed business as

To foster and promote Christian, religious, charitable and educational enterprises.

* * *

This corporation * * * does not contemplate pecuniary gain or profit to the members thereof * * *

The Articles also set forth a doctrinal statement describing the foundation upon which this corporation is based, as follows:

Article IV.

The foundation upon which this corporation is based is a heart-conviction of the truth of the following Doctrinal Statement:

1. We believe that the entire Bible is the inspired and inerrant word of God, the only infallible rule of faith and practice.

2. We believe that the Lord Jesus Christ is the only begotten Son of God, conceived by the Holy Spirit and born of the Virgin Mary.

3. We believe in the literal, bodily, physical and premillennial return of Jesus Christ.

4. We believe in the sacrificial and vicarious death of the Lord Jesus Christ on the cross and that He thereby made perfect substitutionary atonement for the sin of the world.

5. We believe that all men are sinners and in an eternally lost condition apart from the saving grace of the Lord Jesus Christ.

6. We believe that acceptance into the family of God and eternal salvation can only be secured by believing in and by faith accepting and receiving the Lord Jesus Christ as personal Sin-bearer, Lord and Saviour.

They direct that each director must reaffirm the doctrinal statement annually, in writing, and that the reaffirmance be filed with petitioner's permanent records. Failure, refusal or neglect to comply with this directive automatically divests the director of his office. The three directors did in fact reaffirm the doctrinal statement during the periods in controversy.

Ralph H. Eaton joined the Capital Christian Church of Phoenix, Arizona, in 1931. He became a member of the official board of the Church in about 1933. He is a life member of Gideons International. He is a director of the Arizona Bible Institute and the Phoenix Central High School, a member of the Layman's Advisory Council of the National Association of Evangelicals, and on the advisory boards of Christ for America, the American Soul Clinic and Bob Jones University of Greenville, South Carolina. In 1944, while attending an international convention of the Christian Business Men's Committee in New York City, Eaton heard a speech by an industrialist who had contributed money to charities and Christian work through his own charitable foundation. Thereafter, he read a book by the same individual which further described the part played by religion in his business pursuits.

Eaton's principal source of income was the Eaton Fruit Company, a business owned by him and his two brothers.

Kent had graduated from Butler University, and came to Phoenix in 1939. He went to work for the Eaton Fruit Company in 1941, and joined the Eaton-Heiskell Construction Company in 1945 as bookkeeper. In January, 1948, he became a salaried employee of petitioner. His duties were to act as office manager, bookkeeper and business manager, and to keep petitioner's minute book. Mr. and Mrs. Eaton had known Kent since about 1937. They had

been members of the same church and of many religious and charitable organizations. Kent was not related to the Eatons. For about two years prior to March, 1947, Kent and the Eatons discussed the formation of petitioner. Mrs. Eaton's interest in Christian work has always coincided with that of her husband.

In or about February, 1947, the Eatons and Kent consulted with Robert Weaver, a duly licensed attorney of Phoenix, Arizona, for the purpose of organizing petitioner. All details of the Articles of Incorporation except Article IV, the doctrinal statement, were left to Weaver for formulation. Article IV had been the subject of numerous deliberations among the incorporators for some time.

In March, 1947, Mr. and Mrs. Eaton transferred to petitioner, certain farm and office equipment in order to enable petitioner to engage in farming business operations. This equipment had been purchased within the previous six months at a total cost of \$1,843.66. The Eatons further transferred to petitioner at about that time all their right, title and interest in and to certain growing crops against which they had advanced to the date of transfer a sum of \$3,520.79. Petitioner agreed to pay that sum to the Eatons. In the spring of 1945, Eaton purchased 110 acres of land on West McDowell Road in Phoenix, Arizona, and transferred that land to a corporate trustee pursuant to two trust agreements. This land was subdivided into lots, and one-tenth interest was sold to one George Heiskell at that time. In April, 1947, the Eatons

transferred to petitioner their remaining nine-tenths interest in the trusts, which was accepted by petitioner's board of directors on April 1, 1947. The net cost of the interest turned over by the Eatons to petitioner was \$27,410.62. On January 1, 1948, Eaton further transferred to petitioner his partnership interest in Eaton & Heiskell Construction Company, a business engaged primarily in contracting the construction of small residences, which was accepted by petitioner's directors at a meeting held January 1, 1948. The total cost to the Eatons of transfers to petitioner during its first fiscal year aggregated approximately \$50,000.

During the periods in controversy, petitioner was engaged in four different businesses: Farming, selling real estate, constructing small residences, and selling sport clothes.

Petitioner's farming operations were conducted on land held under five leases. Under a lease dated March 20, 1947, petitioner leased from Eaton 80 acres of land known as the L Avenue Ranch for one year beginning February 1, 1947, at a rental of \$40 per acre per year. This lease was renewed for another year at its expiration at the same rental. The original rental and the renewal were authorized by petitioner's directors. Petitioner further leased land known as the Swant Ranch from E. H. Swant for one year beginning July 1, 1947, at a rental of \$30 per acre per year. On or about July 1, 1948, Eaton purchased the Swant Ranch and entered into a new lease between himself and petitioner for one year beginning July 1,

1948, at a rental of \$40 per acre per year. On or about April 1, 1948, Eaton purchased 40 acres of farm land on Ramona Road, Phoenix, Arizona, and leased 35 acres thereof to petitioner for a period of one year beginning April 1, 1948, at a rental of \$40 per acre per year. Petitioner also leased from one Lovell T. Rousseau a ranch known as the Rousseau Ranch for a term of approximately six months beginning July 1, 1948, and at a rental of \$60 per acre per year. Petitioner leased a certain ranch known as the Mann Ranch from T. A. Mann for a term of one year beginning August 1, 1947, at a rental of \$35 per acre per year. This lease was renewed at its expiration for an additional six months, at a rental rate of \$45 per acre per year. All of these leases and their renewals were authorized by petitioner's board of directors.

Petitioner's farming operations were managed by one L. E. Eastes pursuant to a contract entered into with petitioner for one year beginning February 1, 1947, and subsequently extended for another year. Eastes is not related in any way to the Eatons or Kent, nor does he own any legal or beneficial interest in petitioner. Neither Mann, Swant nor Rousseau are related to Kent or the Eatons, nor do they have any interest in petitioner.

Petitioner's net income from its farming operations during the periods in controversy was as follows:

3/12/47 to 1/31/48	\$16,731.14
2/ 1/48 to 1/31/49	7,095.23

The L Avenue Ranch was formerly leased by Eaton to the Eaton Fruit Company at the same rental later paid by petitioner.

Eaton charged petitioner for the rental of his lands because of financial necessity. He had purchased the Swant Ranch and Ramona land on an installment basis, and his combined payments per year, including amortization of principal on these properties were more than three times the rental he received from petitioner. He also expended substantial sums in improving these properties.

Petitioner's subdivision operations consisted of selling the subdivided lots contained in the land which had been subjected to trust agreements. Petitioner's net income from these operations for the periods in controversy was as follows:

3/1/47 to 1/31/48	\$49,089.41
2/1/48 to 1/31/49	2,784.06

In or about November, 1945, Eaton entered into a partnership with George M. Heiskell under the name of Eaton & Heiskell Construction Company, to engage in general contracting. In January, 1948, petitioner purchased Heiskell's interest in the company for its book value. Simultaneously Eaton donated his interest in the company to petitioner. Petitioner has operated the business under its original name since that time. Heiskell was employed to manage the business for petitioner under a written contract, the terms of which provided for one year of employment beginning January 1, 1948. The term was extended in fact for an additional month, to January 31, 1949. Heiskell is not related

to the Eatons or to Kent. Petitioner derived the following net income from its construction operations during the periods in controversy:

3/12/47 to 1/31/48	(none)
2/1/48 to 1/31/49	\$7,551.52

On June 2, 1947, pursuant to authorization of its directors, petitioner acquired the distributorship within the State of Arizona of certain sport clothes manufactured by one C. F. Smith. Petitioner operated this business under the name of "Hollywood Sportogs of Arizona," and was to receive 10 per cent of all gross sales. This business activity was discontinued on June 1, 1948, due to management difficulties and lack of sales. Petitioner incurred net losses from this business during the periods in controversy as follows:

3/12/47 to 1/31/48	(\$533.83)
2/ 1/48 to 1/31/49	(134.39)

Petitioner's directors discussed its business activities fully before undertaking each of them, and were completely agreed on petitioner's course of action in all cases.

At a meeting of the directors on May 1, 1947, petitioner adopted a list of 26 named beneficiaries engaged in charitable or religious work to whom its funds would be made available, in its discretion. It also provided for contributions of not more than \$10 by petitioner's president to miscellaneous organizations engaged in charitable and religious work, without necessity for consulting the Board. At a Board meeting held on January 1, 1949, seven

additional named beneficiaries were added to petitioner's list. This list was compiled after a thorough investigation of the activities of each organization. Petitioner kept a file on each. All beneficiaries had to be and are engaged in activities which carried out the purposes and ideas for which petitioner was established. None of them is engaged in the carrying on of propaganda or in efforts to influence legislation. None of them has any private, beneficial or personal interest in petitioner. No beneficiaries are individuals; any names of individuals on petitioner's list appear as representatives of an organization. During the periods in controversy, petitioner made contributions to beneficiaries as follows:

3/12/47 to 1/31/48	\$4,240
2/ 1/48 to 1/31/49	2,310

In addition to monetary contributions, petitioner rendered consultative services to some beneficiaries. Petitioner's officers assisted in planning two church building programs.

Except for rental payments, interest on money borrowed, payment for costs advanced by Eaton on certain equipment and growing crops, and repayment of loans, petitioner paid nothing of tangible value to Eaton or to his family during the instant taxable years. Eaton rendered substantial services to petitioner. The only compensation received by Kent is a weekly salary of \$100, paid since January 1, 1948, when he began devoting his full time to petitioner's affairs. He has rendered substantial services to petitioner.

Petitioner relied for its tax information on a firm of certified public accountants and tax consultants which enjoyed an excellent reputation in the field of income taxation among prominent business men in the Phoenix community. The Phoenix manager of this firm advised petitioner that it was an exempt corporation and did not have to file Federal income tax returns. Petitioner filed an application for exemption signed by Ralph H. Eaton, president, under section 101(6) of the Internal Revenue Code on or about June 14, 1948, on the advice of these tax consultants.

On April 8, 1949, petitioner was advised that its claim for exemption had been denied. On May 9, 1949, petitioner filed a protest to the Commissioner's finding. Upon learning that petitioner's exemption claim had been rejected, petitioner's tax consultants advised it to file Federal income tax returns for the periods in controversy, which petitioner did on May 13, 1949. Petitioner's failure to file timely Federal tax returns for the periods in controversy was due to reasonable cause and not to willful neglect.

OPINION

The claim of petitioner, a corporation conducting exclusively business operations, for exemption under section 101(6), Internal Revenue Code,¹ as a

¹“Sec. 101. Exemptions From Tax on Corporations.

“The following organizations shall be exempt from taxation under this chapter—

“(6) Corporations, and any community

“feeder” corporation of unmistakably exempt religious organizations must be rejected because “The Tax Court has * * * indicated that it had not changed its thinking on this point despite a reversal by the Court of Appeals for the Third Circuit * * *. Cf. *C. F. Mueller Co.*, 14 T. C. 922, revd. 190 F. 2d 120 * * *.” *John Danz*, 18 T. C. 454, 461. On this point petitioner candidly concedes that after the Mueller decision “* * * the Tax Court has consistently held in line with the Mueller decision, despite the reversal of the latter by the 3rd Circuit.” It also correctly analyzes the conflict among the various Circuits on this point,² resolution of which by the Supreme Court, whether or not likely in view of the modification of section

chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation;”

²Again quoting from petitioner’s brief:

“To attempt to reconcile the viewpoint of the majority of courts that destination controls over source with the current viewpoint of the Tax Court and the two ‘dissenting’ circuits (the 4th and the 7th) would seem to be an impossible task.”

101(6) contained in the Revenue Act of 1950,³ has not yet taken place.

The only discussion in the Court of Appeals for the Ninth Circuit to which we have been referred, *Squire vs. Students Book Corp.*, 191 F. 2d 1018, is actually noncommittal on the present facts, as witnessed by the following language in that opinion:

Resolution of the case before us does not depend wholly on the ultimate destination of the taxpayer's profits. The business enterprise in which taxpayer is engaged obviously bears a close and intimate relationship to the functioning of the College itself. In some of the cases adhering to the general rule no similar relationship is discernible. In the *Mueller* case, *supra*, for example, * * * the taxpayer was a mere macaroni manufacturing plant in competition with other such plants.

See *Trinidad vs. Sagrada Orden de Predicadores*, 263 U. S. 578.

We accordingly pass other difficult questions lurking in the present record, such as the fact that petitioner operated property rented to it by its founder and guide, Ralph Eaton, who with his wife constituted two-thirds of petitioner's board of directors; its failure to distribute more than a small fraction of its own operating income even to the

³Revenue Act of 1950, section 331.

beneficiary religious organizations;⁴ and to borrow the language of petitioner's brief: " * * * the admitted absence of an express prohibition in the Articles against the return of assets to petitioner's founders on dissolution." See Norton, et al., vs. Steinfeld, et al. (Ariz.), 288, pp. 3, 6; 16 Fletcher on "Corporations," 878. Whether under such circumstances petitioner could in any event qualify as an organization operated "exclusively" for religious purposes "no part of the net earnings of which inures to the benefit of any private shareholder or individual" we need not now decide. For the reason stated, the deficiency in this respect is approved.

As to the penalty issue, the doubtful state of the law clearly justified petitioner's resort to qualified tax counsel. It was upon his advice that an application for exemption rather than a tax return was filed. We think under the circumstances there has been a showing of reasonable cause rather than willful neglect. See William H. Gross, 7 T. C. 837, 848.

Decision will be entered under Rule 50.

4

Year	Total Adjusted Operating Income	Contributions Actually Made	Contributions Allowed as De- ductions (5% of Net Income)
3/12/47 to 1/31/48	\$65,510.49	\$4,240.00	\$3,222.03
2/ 1/48 to 1/31/49	17,633.92	2,310.00	302.95

Entered February 27, 1953.

Received February 20, 1953.

Served March 2, 1953.

The Tax Court of the United States

Docket No. 30,985

RALPH H. EATON FOUNDATION,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Respondent having on May 4, 1953, filed a re-computation of tax for entry of decision as in accordance with Memorandum Findings of Fact and Opinion of the Court, entered February 27, 1953, and this proceeding having been called from the Washington, D. C., calendar on June 3, 1953, at which time there was no appearance for the petitioner, and the recomputation of the respondent was not contested, now therefore, it is

Ordered and Decided: That there are deficiencies in income tax and no penalties for the years and in the amounts as follows:

March 12, 1947, to January 31, 1948. .	\$23,263.05
Year ended January 31, 1949	1,223.88

/s/ CLARENCE V. OPPER,
Judge.

Served June 8, 1953.

Entered June 8, 1953.

[Title of Tax Court and Cause.]

CERTIFICATE

I, Victor S. Mersch, Clerk of The Tax Court of the United States, do hereby certify that the foregoing documents, 1 to 21, inclusive, constitute and are all of the original papers and proceedings on file in my office as called for by the Designation of Contents of Record on Review (except exhibits 1-A through 7-G, attached to stipulation of facts, and petitioner's exhibits 8 and 9, admitted in evidence, which are separately certified and forwarded herewith) on file in my office as the original and complete record in the proceeding before the Tax Court of The United States entitled: "Ralph H. Eaton Foundation, Petitioner, vs. Commissioner of Internal Revenue, Respondent, Docket No. 30,985," and in which the petitioner in The Tax Court proceeding has initiated an appeal as above numbered and entitled, together with a true copy of the docket entries in said Tax Court proceeding, as the same appear in the official docket book in my office.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 11th day of September, 1953.

[Seal] /s/ VICTOR S. MERSCH,

Clerk, The Tax Court of the
United States.

[Endorsed]: No. 14,047. United States Court of Appeals for the Ninth Circuit. Ralph H. Eaton Foundation, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Petition to Review a Decision of The Tax Court of the United States.

Filed September 21, 1953.

/s/ PAUL P. O'BRIEN,

Clerk of the United States Court of Appeals for
the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

T. C. Docket No. 30,985

RALPH H. EATON FOUNDATION,
Petitioner and Appellant,
vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent and Appellee.

STATEMENT OF POINTS

Ralph H. Eaton Foundation, the petitioner herein, by Martin H. Webster, its attorney, hereby asserts the following errors, which it intends to urge on review by the United States Court of Appeals for the Ninth Circuit of the decision of the Tax Court of the United States rendered in the above cause on June 8, 1953:

(1) The Tax Court erred in finding that the petitioner was not an exempt corporation under Section 101(6) of the Internal Revenue Code for the periods from March 12, 1947, to January 31, 1948, and for the fiscal year ended January 31, 1949.

(2) The Tax Court erred in failing to find that the petitioner was organized exclusively for religious, charitable or educational purposes.

(3) The Tax Court erred in failing to find that the petitioner was operated exclusively for religious, charitable and educational purposes.

(4) The Tax Court erred in failing to find that, for the period from March 12, 1947, to January 31, 1948, and for the fiscal year ended January 31, 1949, no part of the net earnings of the petitioner inured to the benefit of any private shareholder or individual.

(5) The Tax Court erred in failing to find that no substantial part of the activities of the petitioner was, during the period from March 12, 1947, to January 31, 1948, and for the fiscal year ended January 31, 1949, the carrying on of propaganda or otherwise attempting to influence legislation.

(6) The Tax Court erred in failing to find as a fact each and all of the statements contained in paragraphs 12(a), 13(a), 14(c), 16 and 20 of the Stipulation executed by counsel for both parties hereto on May 20, 1952, and duly received in evidence as a part of the proceedings before the Tax Court in this matter.

(7) The Tax Court erred in entering its decision wherein it ordered and decided that there is a deficiency of \$23,263.05 due from the petitioner for the period from March 12, 1947, to January 31, 1948, and a deficiency of \$1,223.88 for the fiscal year ended January 31, 1949.

/s/ MARTIN H. WEBSTER,
Counsel for Petitioner.

Affidavit of mailing attached.

[Endorsed]: Filed September 30, 1953.

[Title of Court of Appeals and Cause.]

STIPULATION

It is hereby stipulated and agreed by and between Ralph H. Eaton Corporation, petitioner on review, and the Commissioner of Internal Revenue, respondent, by their respective counsel, that all exhibits introduced into evidence in this proceeding, being exhibit numbers 1-A through 7-G (attached to the stipulation introduced into evidence) and exhibit numbers 8 and 9, may, subject to the approval of the Court, be not printed but that they be transmitted to the Court in their original form and be referred to in all briefs and the oral argument to the same extent as though they were part of the printed record.

/s/ MARTIN H. WEBSTER,
Counsel for the Petitioner.

/s/ H. BRIAN HOLLAND,
Assistant Attorney General,
Counsel for the Respondent.

[Endorsed]: Filed November 19, 1953.

